

THE GST COMPLIANCE COSTS OF NONPROFIT ORGANISATIONS

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**MYLES MCGREGOR-LOWNDES
AND
DENISE CONROY**

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**Centre of Philanthropy and Nonprofit Studies
Queensland University of Technology
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Published by the Centre of Philanthropy and Nonprofit Studies
The Queensland University of Technology
GPO Box 2434
BRISBANE QLD 4001
Phone: 07 3864 1020
Fax: 07 3864 9131
Email: cpns@qut.edu.au
<http://cpns.bus.qut.edu.au>

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ABSTRACT

On 2 December 1998, the Federal Government tabled their policy paper entitled Regulation Impact Statement for the Introduction of a Goods and Services Tax (RIS) in the House of Representatives. The Federal Government predicted that total gross GST compliance costs to Australian businesses in the first year of implementation would be approximately \$1,912 million (or \$1,195 per firm). Furthermore, it is estimated that the recurrent net compliance costs will be much lower at \$131 per firm. Whilst the government made brief references to charitable organisations in their analysis, it stated that the compliance costs faced by nonprofits would, in substance, be no different to the compliance costs faced by businesses or government departments.

This paper examines the RIS process in relation to nonprofit organisations in the context of recent taxation legislation affecting nonprofit organisations. It argues that the assumption that nonprofit compliance costs are similar to government and business costs is flawed and makes a case for the RIS process to be reformed to include more appropriate assessments of the impact of legislation on nonprofit enterprises.

INTRODUCTION

The New Tax System¹ represented the largest reform since federation to the Australia's taxation system for all taxpayers. Large sections of the nonprofit sector are outside the income tax system because of their self-assessed income tax exemption and gift deductibility status. This did not insulate the sector from the consequences of the reforms that included the:

- ♦ introduction of the Goods and Services Tax;
- ♦ phasing out of Wholesale Sales Tax exemptions;
- ♦ introduction of Australian Business Number (ABN) regime;
- ♦ introduction of altered Fringe Benefits Taxation for nonprofit bodies;
- ♦ proposed introduction of trusts being taxed as companies;
- ♦ introduction of compulsory endorsement of all charitable institutions and funds as income tax exempt organisations;
- ♦ introduction of compulsory endorsement of all deductible gift organisations and funds;
- ♦ introduction of new arrangements for withholding tax in respect of employees, consultants, and those without an Australian Business Number; and
- ♦ new provisions for the classification of gifts and their deductibility.

It is to be expected that any significant policy shift and implementation program will bring with it burdens for both the government and citizens. In recent years, more attention has been paid to reducing the cost of regulation for government and citizens. This development has been evident in the Federal sphere, both through review of existing regulation and a more appropriate crafting of emerging policy and regulation.²

The introduction of The New Tax System is an ideal case study to examine the robustness of the processes put in place to ensure more appropriate regulatory mechanisms. It was a very significant national policy initiative. However, this paper's focus is narrower, as it seeks to examine the role of one regulatory improvement strategy known as a Regulatory Impact Statement (RIS) in respect of just one sector of the Australian economy, the Third or nonprofit Sector. The Third Sector or nonprofit sector consists of:

“private organisations:

- ♦ that are formed and sustained by groups of people (members) acting voluntarily and without seeking personal profit to provide benefits for themselves and others,
- ♦ that are democratically controlled and,
- ♦ where any material benefit gained by a member is proportionate to their use of the organisation”³

Lyons estimates that the Third Sector has 633,758 employees, with \$58,953 million turnover in 1995/96 with over 700,000 organisational entities.⁴ It is a significant part of the Australian economy whose importance to civil society and social capital creation is only now being appropriately recognised.

The preparation of a RIS is proposed by government as a “critical feature of the regulation making process, primarily because doing so formalises and evidences the steps that should be taken in policy formation.”⁵ It takes the form of a policy document that is publicly released on the introduction of the Bill into Parliament, but is usually prepared at the early stages of the policy development process. The benefit of preparing a RIS is to ensure that options to address a perceived problem are dealt with

1 The New Tax System is the name commonly used for the legislative package which followed the 1998 Federal Election proposed by the Coalition's policy document, Australia, *Tax Reform: Not a New Tax - a New Tax System*, Ausinfo, Canberra 1998, which became known as "ANTS".

2 Australia, *Grey Letter Law – Report of the Commonwealth Inter-Departmental Committee on Quasi-legislation*, December 1977, Canberra, Ausinfo.; J. Howard, *More Time for Business*, Canberra, AGPS, 24 March 1997.

3 M. Lyons, *Third Sector: The Contribution of Nonprofit and Cooperative Enterprises in Australia*, Sydney, Allen & Unwin, 2001, 5.

4 Ibid., 31.

5 Office of Regulation Review, *A Guide to Regulation*, 2nd ed, Canberra, Ausinfo, 1998, B1.

transparently, with all options considered in an analytical process where the benefits of any regulation should outweigh the costs.

The task addressed in this paper is to examine the appropriateness of the RIS accompanying The New Tax System legislation in respect of the nonprofit sector. The paper does this by explaining the general purpose of a RIS and then critically examining The New Tax System RIS for its policy formation in relation to the nonprofit sector. Both the Australian Taxation Office and the watch dog of regulatory matters, the Office of Regulation Review (ORR), have prepared reports which touch upon the usefulness of the particular RIS and these are examined. Finally, we make some recommendations for improving the RIS for nonprofit sector policy formation.

General Purpose of a Regulation Impact Statement

The Australian RIS has its origins in a British development. Since 1985, all UK government departments have been required to compile Compliance Cost Assessments whenever proposals affecting business are legislated. The process was revised and strengthened in 1996 to require ministerial sign off before cabinet consideration of regulatory initiatives.⁶

In Australia, the election of the Federal Coalition Government in 1996 saw them take up many of these concepts in a Small Business Deregulation Task Force Review of the compliance and paperwork burden placed on small and medium enterprises.⁷ At the same time there was considerable interest in reducing the burden of business tax compliance.⁸ The Joint Committee on Public Accounts had previously recommended that taxation legislation should be supported by a Taxation Impact Statement.⁹

In 1997, the Prime Minister announced that RISs would be prepared for all proposed new or amending legislation and treaties.¹⁰ The Industry Commission, now the Productivity Commission, was to act as a watchdog and annually assess the compliance with the procedures through the establishment of an Office of Regulatory Review (ORR).¹¹ That office has produced *A Guide to Regulation* that outlines the RIS specification and development process and is now in its second edition.¹² The ATO has also adopted its own guidelines for the preparation of a RIS which complements the Guide.¹³

The RIS is a document prepared by the responsible authority and has seven key elements which are:

“The problems or issues which give rise to the need for action;
the desired objective(s);
the options (regulatory an/or non-regulatory) that may constitute viable means for achieving the desired objectives(s);
an assessment of the impact (costs and benefits) on consumers, business, government and the community of each option;
a consultation statement;
a recommended option; and
a strategy to implement and review the preferred option.”¹⁴

6 The Deregulation Initiative, *Checking the Cost of Regulation: A Guide to Compliance Cost Assessment*, London, HMSO, 1996.

7 Liberal National Coalition, *A New Deal for Small Business - the Coalition's Small Business Policy*, Canberra, February, 1996.

8 C Evans and M Walpole, "Compliance Costs and Taxation Impact Statements", *Australian Tax Forum*, 1997, Vol 13, 227-275, at 230-1.

9 Joint Committee on Public Accounts, *Report 326 An Assessment of Tax*, Canberra, AGPS, November 1993, 5.67.

10 J Howard, op. cit.,.

11 Industry Commission, *Regulation and its Review 1994-5*, Canberra, Office of Regulatory Review, 1995

12 Office of Regulation Review, *A Guide to Regulation*, 2nd ed., Ausinfo, Canberra, 1998.

13 ATO, Revenue Analysis Branch, *ATO Guidelines for the Preparation of Regulation Impact Statements (RIS)*, Canberra, September, 1998.

14 Office of Regulation Review *A Guide to Regulation*, op. cit., B2.

The RIS should be prepared once an administrative decision has been made that regulation may be necessary, but before a policy decision has been made by government. There should be consultation with those affected by the proposed regulation at an early stage of policy development.¹⁵ The RIS is examined by the ORR and it provides advice to the government on the adequacy or otherwise of it. The ORR also annually publishes an overall assessment of whether the RIS's are faulty as well as their comparative quality. These annual reports have progressively become more sophisticated in their evaluation of RISs and have raised quality standards for such documents.

The New Tax System Regulation Impact Statement

The government made the RIS accompanying The New Tax System Legislation public on the day the legislation was introduced into the House of Representatives.¹⁶ There are three preliminary issues that bear upon our task of assessing the benefit of the RIS for nonprofit tax policy. The first is that the RIS was unorthodox as it was not really used in the policy formation process, secondly the RIS purports not to have to deal with many policy issues that impact on nonprofit organisations, and, thirdly, there is quite a developed Australian and international literature on taxation compliance costs that in part the RIS ignored.

The first preliminary issue is that the RIS was processed quite differently to an orthodox RIS as it was not prepared for use in policy making. As the measures were specific elements or integral parts of an election campaign policy, the ANTS (A New Tax System) proposal made public just prior to the 1998 election, a RIS for policy making is not required. *A Guide to Regulation* does not require a RIS to be prepared at this stage "if the regulation reflects a specific election commitment and there is no scope to consider alternative ways to meet that commitment."¹⁷

The ORR is of the belief that the RIS has a most beneficial impact in the early policy development phase.¹⁸ The Chairman of the Productivity Commission, in a speech during 2001 on Challenges for Australia in Regulatory Reform, noted several deficiencies in the RIS process, identifying the most telling deficiency for good policy formation was the timing of the impact statements. He said,

"To be at all useful in helping to get better regulatory outcomes, they [RISs] need to be prepared as an input to decision making. In other words, they need to be embedded in the policy development process. Instead, in many cases they are being treated as an 'add-on', essentially prepared after policy decisions have already been made. In those circumstances, the Regulation Impact Statement becomes little more than a rationalisation of predetermined approaches. Its content may end up being adequate, but its role is subverted."¹⁹

The New Tax System Legislation was the subject of a large number of substantial amendments over a considerable period of time both in minor detail and major policy substance. This was particularly acute for the nonprofit sector with major policy alterations in respect of registration for GST, definitions of GST-free transactions, treatment of fundraising activities and reporting. The continued alterations placed pressure on organisations trying to plan for a transition to the new taxation regime adding to start up and compliance costs. It is acknowledged in *A Guide to Regulation* that RIS taxation measures may need to be withheld from the public to avoid adverse tax avoidance consequences for the revenue base, however this is hardly the case with most nonprofit taxation provisions.²⁰

15 Ibid., B8.

16 Australia, *Regulation Impact Statement for the Introduction of A Goods and Services Tax*, Tabled in the House of Representatives on 2 December, Cat no. 98 3734 1, 1998, hereinafter "RIS".

17 Ibid., B4.

18 Productivity Commission, *Regulation and its Review 1999-2000*, Canberra, Ausinfo, 47 and Gary Banks, *Challenges for Australia in Regulatory Reform*, address to the conference, Regulation Reform Management and Scrutiny of Legislation, hosted by the NSW State Parliament, Sydney, 10 July 2001, 9. <http://www.pc.gov.au>

19 Ibid.

20 Office of Regulation Review, 1998, op. cit., B4.

The second preliminary issue is that *A Guide to Regulation* significantly defines a large part of the nonprofit sector to be outside the RIS process. This is because “ ‘business’ includes any private organization which aims to make a profit, the commercial activities/transactions of not-for-profit organizations, and any government business enterprise.”²¹ Thus, despite the size and importance of the nonprofit sector, an RIS is not required to comprehensively consider other than commercial transactions.²² Despite this definitional limitation the RIS does deal with some non-commercial supplies.

The third issue is that there is, in comparison to other areas of regulatory compliance, quite a developed international literature on measuring taxation compliance costs. Several Australian studies have attempted to verify the claim of small business lobbies that taxation compliance costs are substantial and regressive.²³ There have also been a number of international studies about similar matters.²⁴ The collection of taxes is not a costless activity and costs are borne by various parties. These costs are usually classified as either compliance costs or administrative costs. Compliance costs are those expenses incurred by taxpayers in meeting the requirements of tax law. Administration costs are those costs that the taxation authorities incur in administering the taxation system such as the salaries of taxation officers and the general cost of their operations. Compliance costs are in the taxation literature categorised as:

- ◆ taxpayer's own labour, unpaid helper and internal staff costs;
- ◆ costs of external advisers;
- ◆ incidental or overhead costs such as specific travel, stationery, postage and computer use;
- ◆ psychic costs associated with the worry of complying with taxation obligations; and
- ◆ social welfare costs which result from a distortion in taxpayer behaviour as a consequence of the existence of taxation.²⁵

The taxation compliance costs of nonprofit organisations have not been specifically studied in the Australian or international literature, and only a few oblique references have been made to their compliance and/or administration costs. The major Australian tax compliance study supported by the ATO specifically excluded nonprofit organisations from the research sample.²⁶ Although there have been a number of international studies of value added taxes, none have adequately addressed the issue of costs for nonprofit organisations.²⁷ These cited studies do establish some significant characteristics generally of a GST in relation to compliance costs and in general they are:

1. gross compliance costs are regressive falling heavily on small enterprise;
2. benefits identified from compliance activities (for example, better record keeping) are even more regressive;
3. a single rate GST has lesser compliance costs than a multi-rate GST;
4. compliance costs diminish over time from their initial introduction; and
5. taxpayers who have mixed GST, exempt and GST-free transactions have higher average compliance costs.²⁸

21 Ibid., B3.

22 Refer to text accompanying footnote 4.

23 C Evans, K Ritchie, B Tran-Nam & M Walpole, *A Report into Taxpayer Costs of Compliance*, Canberra, AGPS, November, 1997; S Rimmer and R Wilson, *Compliance Cost of Taxation in Australia*, Staff Information Paper, Office of Regulation Review, Canberra, AGPS, 1996; I Wallschutzky and B Gibson, "Small Business Cost of Tax Compliance", *Australian Tax Forum*, 1993, 10(4), 511-543.

24 For example, studies mentioned in C Sandford and J Hasseldine, *Administrative and Compliance Costs of Taxation*, Bath, Fiscal Publications, 1989.

25 Ibid.

26 C Evans, K Ritchie, B Tran-Nam & M Walpole, op.cit. .5.

27 C Sandford and J Hasseldine, *The Compliance Costs of Business Taxes in New Zealand*, Wellington, Institute of Policy Studies, 1992; R Plamondon, *GST Compliance Costs for Small Business in Canada*, Canada, Finance Canada, 1993; C Sandford, M Goodwin, P Hardwick, M Butterworth, *Costs and Benefits of VAT*, London, Heinemann Educational Books, 1981.

28 C Sandford and J Hasseldine, op. cit., 6.

The RIS's treatment and classification of such costs will be dealt with below, but first the paper examines the thrust of the RIS accompanying The New Tax System.

The stated objective of the policy is in short to reduce costs to business by abolishing a range of inefficient taxes and replacing it with a broad based goods and services tax. The statement identifies charities as a group to be impacted by the introduction of a GST. It says,

"GST will remove the impact of indirect taxes on charities. Industry cost reductions will result in lower operating costs to these bodies. They will also benefit from the GST-free treatment of the non-commercial supplies of goods or services. All GST participants who are in a net refund position will be able to choose a monthly tax period and thereby get a refund at the beginning of the next month.

These bodies, for GST purposes, face similar considerations to business and government, depending on the precise scope of their activities. For example, charities that run assistance programs are very similar in their operations to the government sector. Conversely, charities undertaking commercial activities operate similarly to commercial businesses. Because of the diversity of their activities these bodies are not separately identified in the following analysis. However, an indication of the impact on these bodies can be inferred from the analysis of the impact on governments and business."²⁹

This statement demands careful scrutiny and is inadequate as a description of the impact of the introduction of the GST on nonprofit organisations, let alone charitable organisations. It is flawed both with and without hindsight in significant respects. Its chief flaws are:

1. **The RIS appears only to address charitable organisations which form only a part of the nonprofit sector.** Approximately 41,500 organisations were endorsed by the ATO as charitable institutions or funds.³⁰ The definition of charity is used in its legal sense and will generally exclude sporting, past time and recreational clubs and societies, trade associations, mutual benefit organisations, advocacy and self-help organisations. As indicated above the nonprofit sector is a significant and growing part of the Australian economy that also performs vital functions in the creation of social capital and maintenance of a civil society. As noted above, Lyons estimates that there are 700,000 Australian nonprofit organisations and the ATO has, one year after the introduction of the GST registered 65,000 of them.³¹
2. **The RIS claims that the GST will remove the impact of indirect taxes on charities.** Charities were usually exempt from indirect state and federal taxes. Many charities are exempt from sales tax, land tax, stamp duty, financial transaction duties, gambling taxes, payroll tax and other minor indirect taxes. The only impact it will remove is the effect of such taxes that have already become part of the cost of previous production stages. Such "embedded indirect tax cost" is that part of the cost of a good or service that can be attributed to the supplier's payment of indirect taxes, such as stamp duty on the purchase of its factory. There appears to be little evidence as to what this will be worth to a nonprofit organisation. It is quite predictable that there will not be an immediate price reduction because the indirect tax has been paid on long-term capital items such as plant, land and buildings. The benefits of such a reduction in the supplier's cost structure will take many years to be fully realised.
3. **It is claimed that GST-free charities will be able to claim a refund from the ATO on any GST that is included in the price of goods and services that they purchase for non-commercial purposes.** The question is whether the financial benefit of being able to engage in GST-free transactions and GST recovery will compensate for compliance costs. Overseas research appears to indicate that taxpayers who have mixed GST, exempt and GST-free transactions have higher

²⁹ RIS, op. cit., 4

³⁰ ATO submission No 298, to the Inquiry into the Definition of Charities and Related Organisations, 19 January 200, 26 <http://www.cdi.gov.au>

³¹ Australian Taxation Office, *GST The First Year: The ATO's Performance Report on GST Administration for 200/01 to the GST Administration Sub-Committee*, 10 September, 2001, 22.

average compliance costs.³² The Regulation Impact Statement acknowledges that,

"Sandford and Hasseldine (1992, p.70) found in New Zealand, partly input taxed or partly GST-free businesses had greater compliance costs than businesses whose activities are all taxable. A study performed in Canada found similar results"³³

This New Zealand study quantified that increase as an average 5% to the total compliance costs over an equivalent business. It should be noted that at the time of the New Zealand study, it had a single rate and a more pure system of GST for nonprofit transactions. The more complex Australian distinctions of what is GST-free compared to New Zealand should have been anticipated to increase compliance costs for nonprofit organisations. Further, unlike the regulatory systems in New Zealand and Canada many Australian nonprofits do not file any financial return with any regulator (including the ATO). This will be their first substantial task with respect to taxation and could reasonably be anticipated to increase costs beyond what was observed in Canada and New Zealand.

4. **The impact statement indicates that nonprofit organisations will be able to obtain a monthly refund of any GST owing to minimise cash flow problems.** There will be added compliance costs associated with accounting on a monthly, rather than a quarterly basis.
5. **The impact statement states that charities have not been specifically dealt with in the impact statement. However, it contends that an indication can be gained from the analysis of government and business impacts that are discussed in detail.** Nonprofit organisations have different attributes to both government and business that ought to be considered by the impact statement. The differences can be summarised as:
 - ♦ Australian nonprofit organisations have largely remained outside the taxation administration system, for example the vast majority of nonprofit organisations do not prepare an income tax return unlike business. government departments have significant accounting and reporting infrastructure and systems;³⁴
 - ♦ nonprofit organisations have different administration and legal characteristics to either government or business entities;³⁵
 - ♦ nonprofit organisations rely on volunteers to a significantly greater extent than either government or business;³⁶
 - ♦ unlike either government or business nonprofit organisations have a high proportion of transactions which are in differing GST classifications; and
 - ♦ volunteers and donors who are essential to most nonprofit organisations have different psychic characteristics to the employees, suppliers and buyers of the government and business sectors.

In summary, the RIS policy statement about charities is incomplete and the statements that were made are inadequately analysed.

32 National Audit Office, *HM Customs and Excise: Cost to Business of Complying with VAT Requirements*, London, HMSO, 1994, 15.

33 RIS, op. cit.6.

34 M McGregor-Lowndes, "Australia", in *Taxation of Non-profit Organisations*, Cahiers de droit Fiscal International, International Fiscal Association, Eilat Congress, 1999, 231-249.

35 K Fletcher, "Developing Appropriate Organisational Structures for Non-profit Associations", in *Legal Issues for Non-profit Associations* edited by Myles McGregor-Lowndes, Keith Fletcher and AS Sievers, Sydney, Law Book Company, Sydney, 1996, 1-21.

36 Australian Bureau of Statistics, *Community Services Australia 1999-2000*, Cat no. 8696.0, 2001.

Comparison to business costs

The paper now turns to examine whether the analysis of business costs illuminates the costs of nonprofit organizations as claimed by the RIS. The RIS identifies that businesses will face three types of compliance costs namely,

- ♦ start up costs;
- ♦ transitional costs; and
- ♦ recurrent compliance costs.

Start up costs are those costs that an entity could expect to face with in the first year of the introduction of the GST for initial staff training, alteration of systems and equipment to cater for the new tax. Transitional costs concern such matters as variations of consumer consumption on the introduction of a GST, whilst recurrent compliance costs are those costs that will remain during the life of the GST.

This classification ignores some elements of the classic international definition of compliance costs that have generally been adopted by those working in the field. The categories of psychic costs and social welfare costs that are notoriously difficult to quantify or predict are omitted. There may be substantial compliance costs for nonprofit organisations because of their unique characteristics in both these categories. This omission is dealt with later in the paper in the context of an analysis of the compliance costs identified by the RIS.

Start up costs

The RIS estimates that for a well run business the start up costs will be less than a normal full year's GST compliance costs. This will be mitigated by business being able to benefit from updating equipment such as computers and accounting programs, revising accounting systems and financial assistance provided by the government of some \$500 million.

The RIS should have forecast that nonprofit organisations could expect higher start up costs because of the following patent factors:

- ♦ Many nonprofit organisations, particularly small organisations with voluntary management, do not have computerised accounting systems;
- ♦ Large nonprofit organisations that sponsor welfare organisations such as churches and religious orders often do not have an integrated computing system or compatible accounting programs;³⁷
- ♦ Nonprofit organisations have not been accustomed to collecting taxation data as they are not required to prepare income tax returns;³⁸
- ♦ Many nonprofit business ventures (eg charity shops) do not have cash registers, stock controls or inventories sufficient to meet the requirements of an income tax regime, let alone GST;
- ♦ Volunteer accounting staff will require training, this is more difficult than training 'for profit' accounting employees, if they are willing to learn new skills at all. Many may choose not to volunteer, thus causing a shift to paying for such skills by nonprofit organisations; and
- ♦ The shortage of accounting professionals to implement GST procedures will impact on nonprofit organisations as they are not generally profitable or substantial clients of professional advisors.

Transitional issues

It would be expected that nonprofits like businesses will experience variations in patterns of consumer consumption before and immediately after the introduction of the GST. Many of the issues for

³⁷ Industry Commission, *Charitable Organisations in Australia*, 1995, No. 45, Melbourne, AGPS, Appendix C.

³⁸ Ibid., p. 274.

nonprofits will be the same as that for business. However, the cost will be magnified by a lack of analysis on the part of the sector as to how their consumers will react. Whereas both big and small business will take advantage of reputable studies conducted by themselves and business associations, there is likely to be less accessible work done on the impact on nonprofit industries.

Recurrent Compliance Costs

Recurrent compliance costs consist of those costs that will be a stable cost of GST compliance on an annual basis. International studies have shown that such costs gradually decline as entities become familiar with its administration.³⁹ A single rate of GST also minimises recurrent compliance costs.⁴⁰

The RIS estimates of the recurrent gross compliance cost for an average business is \$1995. Such an average is misleading as all international studies have shown that small business incurs proportionately greater compliance costs to large business and to average this figure is to mislead the reader. This is compounded by the RIS's itself when it state that "However, the cost is generally greater for larger businesses, with less impact on smaller businesses."⁴¹ Many studies actually show that large businesses are advantaged by a GST by cash flow factors because of the ability to manipulate cash flows and centralise financial operations.⁴² However this does not necessary apply to the nonprofit sector because of some fundamental structural differences.

Large nonprofit bodies that one may typically assume will have lower compliance costs as does large for profit business, may in fact have compliance costs similar to that of smaller enterprises. This is because many large nonprofits such as churches and state wide branch organisations are really federations of small bodies, rather than a centrally based business organisation. The denominational churches in Australia are some of the largest employers with large land holdings that put them among the largest of state based enterprises. In these denominations, each individual church has separate accounts and often each sub-entity (for example, tennis club, youth group or fellowship) within a church has a separate account with little consolidation and no real control co ordination or administrative control. Their size and lack of central treasury functions serves to increase compliance costs in comparison to large for profit business enterprises.

The RIS claims that the average firm compliance cost will be reduced to just \$130 by virtue of:

- ◆ the removal of sales tax,
- ◆ abolition of state taxes,
- ◆ cash flow benefits to those that are required to pay GST to the ATO quarterly, and
- ◆ business will be able to recover input taxes .

These factors do not apply to nonprofit organisations because:

- ◆ many were exempt from paying sales tax and state taxes;
- ◆ some may experience negative cash flow impacts as they receive positive refunds from the ATO because of a dominance of GST-free transactions in their activities;
- ◆ they cannot claim a tax deduction as they do not pay income tax in the first place; and
- ◆ they will not be advantaged by the reduction of compliance costs from the abolition of such taxes because they never subject to these compliance costs.

Apart from the advantages of an investment in more productive business equipment and accounting systems, there seems to be no obvious offset for nonprofit compliance costs.

39 National Audit Office, op. cit., 19.

40 Ibid.

41 RIS, op. cit., note accompanying the Table on page 8.

42 National Audit Office, op. cit., 23.

Also, the RIS claims that businesses will have reduced compliance costs because a well run business will already have most of the material from their other existing tax returns that are being consolidated on a quarterly basis. As has been pointed out before nonprofit organisations do not prepare such records because they are not required to submit income tax returns.

The Explanatory Memorandum accompanying the introduction of an Australian Business Number notes that any compliance costs to business will be reduced by any eligible tax deductions.⁴³ Once again, nonprofit organisations do not have income tax liabilities against which to offset it.

Compliance Costs for Government

There is little relevant information in this part of the RIS that can assist in an assessment of the compliance costs of nonprofit organisations. This is because the focus is on administrative, rather than compliance, costs. There is no analysis of the compliance cost of a government department or quasi government entity that is within the GST regime, that might serve to assist a nonprofit organisation a forecast of their compliance costs.

The RIS comments on the scope of GST-free areas and forecasts that any broader approach to the definition of what is GST-free will result in more complex definitional issues with accompanying administrative inefficiencies, scope for tax avoidance and reduction of revenue. This is fact was partly the outcome with an extension of the GST-free areas such as food.

What is Missing from the Regulation Impact Statement

The Regulation Impact Statement has inadequately addressed the first three types of compliance costs generally accepted in the literature, but has chosen to completely ignore the psychic costs and the social welfare costs that result in a distortion of taxpayer behaviour.

Psychic costs

Psychic costs refer to the costs of worrying about complying with taxation obligations. Such costs will manifest themselves in the retention or recruitment of volunteer treasurers and board members. The volunteer treasurer is one of the most difficult classes of volunteers to recruit and the GST will provide a ready excuse for many already reluctant treasurers to retire or other potential candidates to refuse to take up a position.

Those professional accountants who supply services on a voluntary or reduced cost basis may also have cause for concern about their liability exposure and the amount of extra work they will be expected to do. It will be an opportunity for professionals who donate their services to increase their charges. In some cases it will cause nonprofit organisations to professionalise their accounting departments. This will be further encouraged by the compliance costs of the proposed FBT reforms for nonprofit organisations.

As volunteer treasurers often change on a regular basis, such training should be an ongoing operation beyond the first year of its introduction. Such training needs to be flexible and accessible. The training needed for a paid full time accountant or accounts clerk is different to treasurers of Meals on Wheels organisations, sporting organisations or self-help disability associations.

Social welfare costs through distorted behaviour

Social welfare costs result from a distortion in taxpayer behaviour as a consequence of the existence of taxation. For example, the imposition of a GST will affect consumer consumption habits in the short term. A nonprofit sector example is the use of salary packaging and Fringe Benefits Tax exemptions. Salary packaging would be minimal in the sector if the tax exemptions were not offered.

⁴³ Explanatory Memorandum to *A New Tax System (Australian Business Number) Bill 1998*, 11

Nonprofit organisations that have less than \$100,000 taxable turnover are not required to register for the GST. As the summary of the case study of New Zealand below reveals, small nonprofit organisations may voluntarily register without considering the full implications of such an act.

This type of organisation is likely to have the highest gross compliance cost with the least offset benefits of any group of entities in Australia. They register in the belief that they will be disadvantaged by not being able to get a refund of previous GST inputs or be pressured by those that buy their services who will be unable to claim an input unless they are registered. Much of the income for many small organisations comes from government contracts. Governments should ensure that no preference is given in its contracting of services to recovery of input taxes. To do so will encourage small nonprofits to register for GST when it is uneconomical for them to do so. However, as we will discuss shortly, this is exactly what happened in Australia.

The volunteer finance staff of such small organisations need to be given the knowledge to properly decide whether it is financially feasible to register.

In summary, the RIS did not adequately explain the impact on nonprofit organisations of the introduction of the GST. This is not surprising given the lack of research on compliance costs of nonprofit organisations combined with non-recognition of the systemic differences of nonprofit organisations from business and government. The statement does acknowledge that the compliance costs of nonprofit organisations will be higher than business costs and this is supported by Canadian and New Zealand compliance cost studies.

Was the RIS accurate?

It is acknowledged that the amendments to the GST legislation forced upon the government by the Senate, particularly the GST-free treatment of food, mean that the RIS was in relation to a policy that was fundamentally altered. On the indication of overseas studies, it could confidently be predicted that compliance costs estimates in the RIS would be significantly lower than that which would be experienced under the altered legislative scheme. It is inappropriate to hold the RIS to account for its compliance cost predictions to a radically altered regime.

It is unfortunate that the ATO has been reluctant to conduct themselves, or facilitate others to conduct, studies of the compliance costs of the new GST regime. The ATO refused access to data and co-operation with respected independent researchers who proposed compliance costs studies of The New Tax System.⁴⁴ The ATO's own performance report on GST administration for 2000/01 stated:

“The annual ATO cost of compliance survey was not run this year in recognition of 2000/01 being an abnormal year with transaction costs to The New Tax System being unduly high.”⁴⁵

This is despite the fact that the RIS did specify implementation costs, start up costs and transitional costs, claiming that “these [implementation] costs will be marginal in the case of well-managed businesses because of their existing obligations for income tax and other accounting purposes” and “start up costs are likely to be one-off expenses and to be lower than the full year compliance costs of GST”.⁴⁶ Although it may be an abnormal year, the RIS considered the impact of implementation costs and it is regrettable that a survey was not conducted. It could have revealed valuable information for future policy formation when significant policy shifts were contemplated.

⁴⁴ E McWilliams, ATO Jeopardizes Study of New Tax System, Melbourne, *The Australian Financial Review*, Tuesday 1 May 2001, 45.

⁴⁵ Australian Taxation Office, *GST The First Year: The ATO's Performance Report on GST Administration for 2000/01 to the GST Administration Sub-Committee*, 10 September, 2001, 27.

⁴⁶ RIS, op. cit., 5.

Since mid-1999, many attempts have been made to quantify the implementation costs of the GST. These costs have ranged from \$4.3 billion⁴⁷ to \$24 billion.⁴⁸ Specifically, most of the Australian studies have focussed on measuring the GST implementation costs borne by small businesses. Tran-Nam⁴⁹ has that estimated recurrent GST compliance costs for small businesses will exceed \$1 billion annually, almost five times the initial Government estimate of \$210 million, whilst the average cost of implementing the GST for Victorian small businesses was estimated at \$12,380⁵⁰.

The only known attempt to quantify the GST start-up costs of NPOs was conducted by the Queensland Council of Social Service Inc. (QCOSS) in June 2000.⁵¹ Based on the responses of 763 participating community organisations, QCOSS found that the average cost of implementing the GST was \$5,601 per organisation. The QCOSS study found GST costs to be regressive, falling more heavily on the smaller NPOs.

Two assessments of The New Tax System administration and compliance costs are available, being the ATO's performance report⁵² and the Productivity Commission's (ORR) annual review of Regulatory Impact Statements.⁵³

Assessment by the ATO

The Interim Performance Agreement signed between the ATO and representatives of the states and territories on 4 May 2001 requires the ATO to report on a series of performance outcomes.⁵⁴ The report explains that 2.19 million ABN registrations was higher than expected because of the impact of the withholding rate implications for those without an ABN or because of wider registration requirements for state and territory government agencies with charities being paid grants.⁵⁵ The RIS forecast that there would be approximately 1.4 million GST registrations. An explanatory Memorandum accompanying statutory rules for ABNs estimated a total of 2.1 million ABN registrations including 200,000 tax exempt bodies. The report reported that the ATO found the Not for Profit Sector as a significant market segment with just over 65,000 registrations with about 38,700 having a turnover of less than \$100,000 and thus being voluntary registrations. The report acknowledges that "this sector has a wide range of needs due to its diversity and complexity."⁵⁶

This is an indication of the lack of current basic knowledge about third sector organisations that such initial projections diverged from what actually occurred. Further research into basic data of the size and nature of the third sector is essential for government if appropriate policy is to be developed through RIS.

Productivity Commission

The Productivity Commission has an obligation to report annually on compliance with the government's requirements for RISs. The second report in 2000, after the introduction of The New Tax System RIS,

47 'Readiness for GST Tipped to Cost \$24 Billion', (2000), Melbourne, *Australian Financial Review*, 6 January, p.6.

48 Ibid.

49 B. Tran-Nam, 'Use and Misuse of Tax Compliance Costs in Evaluating the GST', *The Australian Economic Review*, 2001, Vol. 34, (3), pp.279-290.

50 Victoria University, *Goods and Services Tax (GST) Implementation and Victorian Small Businesses, Final Report*, Small Business Research Unit for Small Business, 2001, Victoria (<http://www.sbv.vic.gov.au>, accessed 9 February 2002).

51 Queensland Council of Social Services Inc., *Taxing Goodwill: The Impact of GST on Community Services*, 2001, Brisbane, October 2001.

52 Ibid.

53 Productivity Commission, *Regulation and its Review 1999-2000*, Asusinfo, Canberra.

54 The Interim Performance Agreement signed between the ATO and representatives of the States and Territories on 4 May 2001 cited in Australian Taxation Office, *GST The First Year: The ATO's Performance Report on GST Administration for 2000/01 to the GST Administration Sub-Committee*, op. cit., 4.

55 Ibid., 4.

56 Ibid., 22.

gave the ATO and Treasury a glowing report and even went so far as to recommend the use of the RIS as a precedent by others and placed it on its web site for examination.⁵⁷ The report in 1999 did not specifically mention the RIS issued at the end of 1998, but, commended the ATO on the coordinated approach they had taken to preparation of RIS generally.⁵⁸

It is hard to come to the same conclusion as far as the RISs application to nonprofit organisations is concerned and it is particularly significant that the watchdog of the RIS process did not take a firmer approach to such matters.

Improvement of The New Tax System Regulatory Impact Statements

As indicated above it is inappropriate to hold the RIS compliance cost predictions up to a radically altered legislative outcome and claim that it was misleading. It has been our argument that the RIS did not consider nonprofit organisations in an appropriate fashion initially, whatever the final outcome of the legislative process. The consequences of a GST on nonprofit organisations could not be gauged by an examination of the RIS's considerations of for profit business or governmental agencies and this is independent of any subsequent legislative amendment. Some parts of the RIS are seriously flawed on their very face and that the Productivity Commission should hold it up as a model RIS is disturbing.

A properly constructed RIS would have highlighted many of the compliance issues that arose for nonprofit organisations. Some were identified during the parliamentary process with inferior 'band-aid' solutions applied and others have remained to inhibit nonprofit organisations. The uncertainty created by a large number of substantial amendments to nonprofit GST provisions to correct basic policy flaws in the GST regime probably compounded the start up costs for such organisations and certainly added to psychic costs that were never recognised by the RIS.

Both the process and the content of the RIS requires improvement as indicated in the foregoing discussion. In particular, attention needs to be paid to:

- ♦ Nonprofit organisations, as an important part of the Australian economy and social fabric, must be fully included in any RIS and this should not be limited to their commercial activities as is presently the case. Nonprofit organisations should not be subsumed in the other categories;
- ♦ More research should be encouraged on the third sector and its organisations in order to provide data to inform RISs;
- ♦ Public notification of RIS preparation (a minimum of 28 days is provided for in most state government legislation).⁵⁹ The policy of omission of an RIS at an early stage where it reflects a specific election commitment requires review, as it clearly caused in this instance a policy development deficiency;
- ♦ Tax RISs should not be withheld on the grounds of tax evasion sensitivities, unless it is real and significant; and
- ♦ The transparency of the policy process; there should be a statement in the RIS about the objectives of the proposed legislation, brief statement about all reasonable alternatives of reaching the policy objectives and why alternatives were rejected, 'costs' to the community (or a part of the community) should be identified in terms of burdens and disadvantages, and direct and indirect economic, environmental and social costs.

⁵⁷ Productivity Commission, *Regulation and its Review 1999-2000*, Canberra, Asusinfo, 2001, 79.

⁵⁸ Ibid., 35.

⁵⁹ See, for example, Section 43, *Statutory Instruments Act, 1992* (Qld).